COVENANT
CAPITAL MANAGEMENT INC.

# INVESTORS' JOURNAL

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## IN THIS ISSUE



## EDITORIAL & MARKET UPDATE

The first quarter of 2015 has seen a continuation of what was started in late 2014 with the fall in oil prices. Since January, oil has seen a low of $44 (WTI on Jan 28th), and by early March it had recovered to a high of $54. It has since settled back down to hover around $50. Market volatility has not been as intense as seen in late 2014. Many economists believe that oil prices have already hit their lowest rate and that oil will steadily climb higher by the end of the year. It is likely that the climb in prices will be gradual, causing limited drama.

Looking forward, we believe the big story in the United States will be related to inflation and interest rates. With respect to growth, the consumer discretionary sector has been positively affected by lower gas prices. Since a huge percentage of US GDP is linked to consumer spending, this is nothing but good news for Americans.

As a result of increased consumer spending, we may see a rise in US interest rates. There appears to be internal pressure for a rate hike, as too much inflation linked to the increase in spending is always a concern. However, statistics are showing that wages have not increased and inflation has remained steady. If wages remain low and inflation is moderated, The Fed will be reticent to hike interest rates. This means cheap money, low energy prices, and likely a strong dollar for the near future. In this environment, a prudent person would pay down their debts and put their financial household in order. It remains to be seen if individuals and businesses in the US will do that (thus keeping inflation manageable) or if they will spend madly, driving prices and rates up.

Canada, on the other hand, has been opposite to the economic position of the US. Our growth potential for the next year or two will be seriously affected as our economy is so tied to resource prices and demand. In response to this potential economic fall-out, the Bank of Canada surprised many this past quarter by abruptly lowering the interest rate. Dropping rates is intended to act as insurance against recessionary forces, but it also comes with risk. The greatest risk associated with an interest rate decrease is the formation of market bubbles financed by debt. History has shown that cheap money can easily lead to irresponsible spending. This has never been of more concern in Canada as it is now. The household debt levels have reached an unprecedented high when compared with GDP, while housing markets in select sectors are booming, specifically in Toronto and Vancouver.

*"In everything I did, I showed you that by this kind of hard work we must help the weak, remembering the words the Lord Jesus himself said: 'It is more blessed to give than to receive.'"*

*– Acts 20:35*

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## EDITORIAL & MARKET UPDATE

As mentioned in our last newsletter, it is worth noting that some areas of Canada are likely to do well within our current economic environment. With a low dollar and cheap energy, provinces that depend on exports will hold their own (such as Ontario and BC). Provinces relying on resource prices and demand will suffer; Alberta will be hit the hardest, followed by Saskatchewan, then Newfoundland and Labrador. It is yet to be determined how the balance of these factors weigh out, but we expect that it will be a net negative.

While there are good reasons for why the interest rate was lowered, we consider the timing to be a bit premature. If the Canadian economy continues to move along steadily, and Harper achieves a balanced budget, we would anticipate the next action by the Bank of Canada to be an increase in the interest rate, returning it back to what it was at the end of 2014. If GDP growth declines significantly and there is an increase in the unemployment rate, there is still room for another decrease in the interest rate or the addition of stimulus to the economy through quantitative easing.

In relation to portfolios, the impact of lowered interest rates positively affected the Canadian bond market last quarter. We continue to diversify our traditional bond and equity exposure to mitigate market risks by including non-traditional components such as construction based mortgages, infrastructure projects and private debt. In addition, portions of our portfolios are rich in cash, allowing us room for good quality opportunities when they are available at excellent prices. Patience and disciple is key to this strategy, but we believe that the volatility and risk reduction is worth it in the long run.

## COVENANT'S POOLED FUNDS SUMMARY

**The following is a summary of our four pooled funds. Please note that returns are as of March 31, 2015*

Our star performer continues to be the **Covenant Mortgage Pool.** With a return of more than 10% annually for the past few years, we have outperformed our 8% annual target since inception in 2012.

Our most conservative pool, the **Fixed Income Pool**, provides both a diversified traditional and non-traditional fixed income approach and is doing exactly what it should. This past year it has provided a 4.98% return.

The **Non-Traditional Equity Pool** offers non-traditional equity investment opportunities such as property development projects and event driven investment funds. This pool is meant to provide equity returns with limited correlation to traditional stock market volatility. As is typical with this type of investment, this past quarter's performance was fairly flat at 1.07% (4.94% since its inception in May). It is important to note that valuations on the investments contained in this pool are not completed every month. Some valuations may not be received until the end of a quarter, for example. Therefore, we expect to see fairly stagnant returns over shorter periods of time with periodic "catch-up" months. This has been the story for this past quarter.

The **Traditional Equity Pool** has returned 1.24% since its inception in November of 2014. This pool invests in traditional stock market securities and has a significant portion of cash on the sidelines, as we are most interested in buying when good quality stock go on sale. Conversely, we sell when prices hit our targets. This pool is expected to be far more correlated to stock market volatility, at least in the short term. Over the long run, however, it is expected that our deep value strategy will "smooth out" the returns to provide a solid return while mitigating significant downside risk.

## PLANNED GIVING

Living generously is a value that we at Covenant Capital Management are passionate about. As a firm that generates income based on the collection of assets, promoting the behaviour of giving money away seems counterintuitive. The truth is, we are always most excited when we see clients stepping forward in faith and discipline to give generously for the purpose of blessing others. With this in mind, we wanted to take a moment to remind you of a few practical steps from a financial perspective to help you more effectively give:

1. Donating stock to a Canadian registered charity is an excellent, tax efficient way to give. In this case, any capital gains that would have otherwise been required to report on the disposition or sale of the security are exempt from tax, but the donor still receives the donation receipt for the full market value of the stock. If a capital loss would be the result of the gift, then the donor should sell the stock, recognize the loss, and then gift the cash.

2. Setting up a foundation is an excellent way to create a legacy of giving for you and your family. At Covenant, we help make this process exceptionally easy through the Covenant Foundation. Setting up a foundation is as simple as filling in a short application form and then making the donation. Some advantages to a foundation include:

    - Allows you to recognize the donation today, while distributing the funds over time
    - Utilizes traditional investment management to prepare for current or future gifts
    - Ensures that your giving plan is thoughtfully and efficiently executed, while serving the intended purpose
    - Allows the gift to remain anonymous, if desired
    - Provides flexibility to the giver by allowing gifts on behalf of a couple, family or group ("i.e., the Smith Family Foundation")
    - Engages the whole family in the act of giving

For more information, please visit our website at www.covenantcapital.ca or feel free to contact us directly by phone at 604-546-1500.

## TEAM UPDATES & REFLECTIONS

The Covenant Capital Management team is excited to announce that we are moving! You won't need to look too far to find us, as our new space is just across the parking lot. While we are thankful for the time that we have spent in the Power to Change building, our growth as a team has increased our need for office space. We are thankful to God for providing a new space that will be ready for us to move into over the summer. As we look toward the future of this company, we continue to rely on God for his wisdom and direction. It is our prayer that we may honour Him in all of the decisions that must be made to adjust with the growth of this company.

Throughout the Easter season, we took time off to ponder the mystery of His grace.

*"For since death came through a man, the resurrection of the dead comes also through a man. For as in Adam all die, so in Christ all will be made alive."*
*- 1 Corinthians 15:21-22*

As we move into the spring and summer season, the beauty of creation reveals God's majesty. The life that springs up all around us reminds us of the remarkable hope that we have through Christ.

*"Praise be to the God and Father of our Lord Jesus Christ! In his great mercy he has given us new birth into a living hope through the resurrection of Jesus Christ from the dead."*
*- 1 Peter 1:3*